Supreme Court of the United States

October Term—1922

THE PUSEY AND JONES COMPANY
(a corporation),
Petitioner,

against

HANS KARLUF HANSSEN, *Respondent,*

and

JACOB PREBENSEN, JR., H. KJERSCHOW, HARRY BORTHEN, A/S TROMP, A/S MARITIM, A/S HAUG, A/S MERCATOR, A/S SORLANDSKE LLOYD and E. and N. CHR. EVENSEN,
Intervenors-Respondents.

No. [illegible].
On Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

BRIEF ON BEHALF OF RESPONDENT

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BRIEF ON BEHALF OF RESPONDENT.

Statement of the Case.

In view of various contentions made as to the status of the respondent in instituting the proceeding below, it is desirable fully to understand the origin and development of this litigation.

The respondent, Hans Karluf Hanssen, is a citizen of the Kingdom of Norway. The Pusey and Jones Company, the petitioner, is a Delaware corporation. Some years ago one Christoffer Hannevig succeeded in acquiring practically the entire capital stock of said corporation. Hannevig was a manipulator of ship contracts and as the event demonstrates, his operations were not restrained by scruple.

The nine Norwegian intervenors-respondents, who are all citizens of Norway or corporations organized under the laws of that Kingdom, purchased from Hannevig a number of contracts for the delivery of ships then under construction and at a time when such vessels were of much value on account of the exigencies of the war. In disposing of the contracts Hannevig represented to these Norwegians that he had already paid the concerns building the ships large sums of money, whereby the future payments under said contracts would be that much diminished. This representation was untrue to the extent of about $1,200,000. These intervenors, therefore, were defrauded to that extent by Hannevig. Discovering this situation they commissioned Hanssen to come to the United States to protect their interests.

Hanssen succeeded in getting Hannevig to reduce the claim to about $800,000. Hannevig acknowledged the amount to be due, and to secure its payment pledged to Hanssen nine promissory notes of the petitioner corporation, the face value of which aggregated $650,000. Most of these notes were payable to Christoffer Hannevig, Inc., a New York corporation, whose stock was owned by Hannevig, and by said corporation were endorsed in blank. The largest one, however, for $300,000, was payable to Hannevig personally and was by him endorsed in blank. All the notes were made and payable in the State of Delaware. Hannevig further pledged as security for the same indebtedness 7,200 shares of the preferred stock of the petitioner corporation, 7,000 shares of which stood in the name of said Christoffer Hannevig, Inc., the certificates for which were endorsed for transfer to Hannevig and by him endorsed in blank. The other certificate for 200 shares stood in the name of Hannevig personally and was by him endorsed in blank for transfer. These promissory notes and certificates of stock were delivered to Hanssen under an agreement of pledge (record, p. 489) and were subsequently repledged by Hannevig sub-

ject to the pledge to Hanssen for the security of other indebtedness. No question has ever been raised concerning the title of Hannevig to said notes and shares of stock, and nothing appears in this record tending to invalidate such title.

Having accomplished the foregoing adjustments Hanssen returned to Norway taking the securities with him. During the succeeding year he made various demands upon Hannevig for the payment of the indebtedness, all of which were unavailing. Hannevig's financial condition becoming more and more critical, Hanssen returned to the United States in April, 1921. Learning of the filing of a certain judgment against The Pusey and Jones Company and the making of a certain agreement in regard to the management of that corporation, he brought the present proceeding for the appointment of receivers. This was done with the full knowledge and consent of the nine intervenors-respondents (record, p. 506).

The bill of complaint sets out the jurisdictional facts showing diversity of citizenship and that the requisite amount is involved, describes the organization and capitalization of the petitioner corporation, alleges the issuance by the corporation of the stock pledged to Hanssen, alleges that the same was sold, assigned, transferred and delivered to him and became his property; that the complainant made demands upon the petitioner corporation for a transfer of the stock on the corporate books into the name of the complainant, which demands were refused; alleges that complainant is a creditor of the respondent corporation on the promissory notes which are fully described; alleges that said notes were assigned, transferred and delivered to the complainant for a good and valuable consideration and that the complainant is the lawful holder thereof; that payment of the notes, though demanded, had been refused; the bill then sets forth the Delaware statute involved in this proceeding,

although it is not stated that the proceeding is entirely based upon said statute; alleges that the respondent corporation was insolvent in that it was unable to pay its obligations as they fell due in the due course of business; alleges that a judgment for upwards of eight hundred thousand dollars had been taken against the respondent corporation; that the respondent corporation had executed its bond to the United States Shipping Board Emergency Fleet Corporation for five million dollars and had secured the same by its mortgage covering all of its plants; that various other litigations were pending against the respondent corporation; that by reason of separate sales under said judgment or said mortgage or in pursuance of said other litigations there would be a great waste of the assets of the respondent corporation and an unequal and inequitable application of its assets to its debts; that a dispute existed between the respondent corporation and said Fleet Corporation involving large amounts of money; that certain creditors, stockholders and representatives of Hannevig, who recently had been thrown into bankruptcy, had entered into an agreement, attached to the complaint, under which a board of directors had been installed in violation of the rights of other stockholders and creditors; that the judgment which had been entered was illegally and unlawfully secured on account of various facts alleged in the bill; that receivers should be appointed with authority to apply to set aside said judgment. Said bill prays for the appointment of receivers to take charge of the business and affairs of the respondent, collect outstanding debts, with power to prosecute and defend actions and with such other powers as might seem proper; for an injunction; that the respondent corporation be decreed to transfer said 7,200 shares of its preferred stock to the name of the complainant and for other relief.

Upon the service and filing of this bill the District Court, on June 9, 1921, *ex parte* appointed Willard

Saulsbury and Charles B. Evans, receivers, basing said action upon the necessity of giving said receivers an opportunity to move to set aside said judgment during the then pending term of the Court, which was about to expire. Said order contains various other provisions unnecessary to mention (record, p. 79). The petitioner immediately moved to vacate said order. Upon hearing the motion to vacate was denied on June 13, 1921 (record, p. 87).

The petitioner filed an answer (record, p. 137). Without reviewing all the denials and allegations in said answer, it is sufficient to say that it denied that said complainant was a stockholder or a creditor of the respondent; alleged that a counter-claim to the notes existed; denied mismanagement or waste; maintained that the respondent was entitled to a jury trial on the question of the complainant being a creditor and alleged that the proceeding could not be maintained in equity in a Federal Court.

Later a further hearing was had and on August 1, 1921, the District Court confirmed its order appointing the receivers (record, p. 603). Upon appeal this order was affirmed by the Circuit Court of Appeals for the Third Circuit and now comes here upon a writ of certiorari (record, p. 652).

POINT I.

The Delaware statute justifies the procedure herein and the action of the Court below.

The Delaware statute involved in this proceeding was enacted over thirty years ago. Its language is as follows:

> "Whenever a corporation shall be insolvent, the Chancellor, on the application and for the benefit of any creditor or stockholder thereof,

> may, at any time, in his discretion, appoint one or more persons to be receivers of and for such corporation, to take charge of the estate, effects, business and affairs thereof, and to collect the outstanding debts, claims, and property due and belonging to the company, with power to prosecute and defend, in the name of the corporation or otherwise, all claims or suits, to appoint an agent or agents under them, and to do all other acts which might be done by such corporation and may be necessary and proper; the powers of such receivers to be such and continued so long as the Chancellor shall think necessary; provided, however, that the provisions of this section shall not apply to corporations for public improvement." Section 3883 of the Revised Code of Delaware (1915).

This statute has been applied frequently both in the State and the Federal Courts and its meaning, as well as the proper procedure under it, cannot now be questioned

Before discussing the question of whether its provisions will be enforced in equity by a Federal Court, it is proper to determine its meaning and application as shown by the decisions.

It is well settled that all that is necessary to enable the Court to proceed is to show, *first*, that the complainant is a creditor or a stockholder, and if a creditor it is not necessary to show that his claim has been reduced to judgment, and *second*, that the corporation is insolvent.

It is further settled beyond question that the procedure under the statute is by the ordinary equitable procedure, a bill of complaint.

Such bills of complaint have been entertained in numerous cases by the Court of Chancery in Delaware, and by the District Court of the United States sitting in equity. Those courts at all times have proceeded under the practice governing all receiverships in equity.

In *Sill* v. *Kentucky Coal Co.* (11 Del., ch. 93) the Court stated:

> "It is not necessary that the complainant be a judgment creditor."

Other State cases in which the statute has been discussed and applied in the courts of Delaware are the following:

> *Thoroughgood* v. *Georgetown Water Co.* (1910), (9 Del., ch. 84; 77 Atl., 720);
> *Mark* v. *American Brick Mfg. Co.* (1912), (10 Del., ch. 58; 84 Atl., 887);
> *Ross* v. *South Delaware Gas Co.* (1914), (10 Del., ch. 236; 89 Atl., 593);
> *In re D. Ross & Son, Inc.* (1915), (10 Del., ch. 434; 95 Atl., 311);
> *Whitmer* v. *Whitmer & Sons, Inc.* (1916), (11 Del., ch. 185, 222, 225; 98 Atl., 940);
> *Hooper* v. *Fesler Sales Co.* (1916), (11 Del., ch. 209; 99 Atl., 82);
> *Badenhausen Co.* v. *Kidwell* (1919), (107 Atl., 297);
> *Jones* v. *Maxwell Motor Co.* (115 Atl., 312).

In *Jones* v. *Mutual Fidelity Company* (123 Fed., 506), at page 523 the Court stated:

> "As before stated proceedings under the Delaware statute are of an essentially equitable nature, and under its settled construction may be instituted and maintained by non-judgment creditors unsecured by any lien or trust."

Whatever may be said as to the meaning of the word "creditor" in other statutes, these and many other decisions leave no question but that in this Delaware statute the term includes unsecured general creditors as well as judgment creditors.

That the Court may proceed upon the sole fact that the corporation involved is insolvent is equally well settled, and in fact is apparent from the terms of the statute itself. That such is the case is settled by the Delaware decisions above referred to and by many decisions in the Federal Courts, among which are *Jones* v. *Mutual Fidelity Company, supra*, and *Adler* v. *Campeche Laguna Corporation* (257 Fed., 789). In the last case mentioned the Court states:

> "The Delaware statute enlarges the jurisdiction of the Courts of Chancery over the appointment of receivers of corporations to include cases where insolvency is the sole ground for the appointment."

That the procedure also is settled to be by ordinary bill of complaint and that such procedure will follow the ordinary course of receivership proceedings in equity is equally well settled. An examination of all the Delaware cases above cited will show that such was the procedure in each instance, and likewise such has been the procedure in every instance in which the jurisdiction of the Federal Court has been invoked.

The scope of the proceedings after the appointment of receivers is also well settled. It is apparent from the cases that such receivers have the general powers of other receivers in equity, and not only the decisions show, but the language of the statute itself indicates, that such a receivership may continue as long as the exigencies of the case may require. It may result in a complete administration of the property of the corporation, or, on the other hand, it may preserve the assets until circumstances indicate that it is proper to turn them back to the directors and stockholders without the adjustment or payment of debts or any distribution whatsoever of property.

That such is the case is apparent from the following statement in the opinion of the Court in *Jones* v. *Mutual Fidelity Company, supra* (p. 523):

> "The powers of receivers appointed under the act are 'such and continued so long as the Chancellor shall think necessary.' The statute contemplates two classes of cases: First, proceedings which may result in the full and final administration and distribution on an equitable basis of the assets of the insolvent corporation among its creditors and, should a surplus from any cause exist, among its stockholders, subject to valid existing liens, if any; and, secondly, proceedings which may result in the taking possession of such assets and their retention by the court until such time as by a prudent, economical and successful management of the affairs of the insolvent corporation, it may be restored to solvency. In the first class of cases the receivership usually continues until the time arrives for final distribution, and, in the second, the receivership continues until the corporation has been restored to solvency."

In *Badenhausen Co.* v. *Kidwell* (107 Atl., 297) the Supreme Court of Delaware, the highest court of the State, outlined the powers of a receiver under this statute as follows:

> "If after the decree of this court shall be certified to the court below, a proper showing should be made to the chancellor, he doubtless would, under the powers vested in him, make such modification of his decree as may be necessary to authorize the receivers appointed by him to continue the business of the corporation respondent below for the express purpose of conserving its assets and restoring it to a condition of solvency.
>
> Or if it should be shown that the corporation respondent below has attained a condition in which it can meet its obligations in the usual course of business, or that there is a reasonable prospect that its business can be successfully con-

tinued, notwithstanding any deficiency of assets, the chancellor would discharge the receivers and permit the corporation respondent below to resume its business."

It is, therefore, apparent that there can be no doubt as to the scope and meaning of the statute here involved. Its purposes seem to be plain and the method of its application seems to be well settled.

POINT II.

The appointment of the Receivers in this proceeding was well within the discretion of the District Court.

Again postponing a discussion of the question as to the power of the District Court to act, it is apparent that if such power existed its action was proper. The appointment of receivers is always discretionary with the Court and we presume it will not be disputed that such discretion will not be disturbed by a court of review unless it was clearly abused.

It has already been indicated that all that need appear to the Court to authorize it to appoint these receivers are the two facts that the complainant was either a stockholder or a creditor, and that the corporation was insolvent.

The complainant was both a creditor and a stockholder, but his status as such will be more fully discussed in other connections.

That the corporation was insolvent is equally apparent. The bill and the affidavits show that a large judgment had been taken against it; that other litigation was pending; that it had refused to pay the notes held by the complainant; that it was involved in a dispute with the Fleet Corporation, each party claiming that millions of

dollars were due from the other; that other circumstances indicated that it was unable to pay its obligations in due course. The appointment of the receivers was on June 9, 1921 (record, p. 79). If any doubt in regard to the insolvency of the corporation otherwise exists that doubt is set at rest by the fact that on July 23, 1921, the corporation filed a voluntary petition in bankruptcy in the Southern District of New York, in which it is recited that the executive committee of the company had passed a resolution with the following preamble:

> "Whereas The Pusey and Jones Company is unable to pay its debts and is insolvent within the meaning of the Acts of Congress relating to bankruptcy" (record, p. 581).

The reasons that moved the District Court to appoint the receivers are fully stated in the opinion of the Court (p. 516). In addition to the insolvency of the defendant it is clearly shown that the reason for haste in the appointment was that the receivers could move to set aside the judgment that had been obtained against the corporation, which would pass beyond the control of the Court within four days of the appointment, and, furthermore, that the then directors of the corporation were installed in pursuance of an agreement that took the management of the corporation from its stockholders and practically vested it in a committee of creditors, contrary to the Delaware statutes governing the conduct of corporations.

Under these circumstances, it cannot be said that the proceedings below have involved any abuse of discretion, provided the Court had jurisdiction of the matter.

POINT III.

The question of the jurisdiction of a federal court to proceed under the Delaware statute at the instance of a creditor who has not reduced his claim to judgment is not determinative of this proceeding.

The assault that the petitioner makes upon the validity of the proceedings below is based almost entirely upon the proposition that the Delaware statute is one which cannot be enforced in equity in the federal courts, the claim being that the respondent had an adequate remedy at law and that the petitioner was deprived of a jury trial contrary to the provisions of the Seventh Amendment.

The importance of these questions is such and the consequences of a decision upholding such contentions are so far reaching, as will be pointed out elsewhere, that possibly this Court will not decide such questions except in a case where such decision is necessary for its determination. We submit that such a situation is not presented by this record for two reasons: *first*, the respondent was a stockholder as well as a creditor and as such could proceed unhampered by any of the obstacles urged by the petitioner; *second*, the intervention of the United States Shipping Board Emergency Fleet Corporation on October 8th, 1921, injected a party that had a direct lien upon all of the valuable real estate owned by the petitioner.

First: The respondent was a stockholder as well as a creditor and as such could proceed unhampered by any of the obstacles urged by the petitioner.

The bill alleges that Hanssen is the owner of 7,200 shares of the preferred stock of the Pusey and Jones Company; he demanded that the stock be transferred

to his name, which demand was refused by the company, and among other things he prays that the Court may decree that said stock shall be transferred to his name.

It appears from the affidavits that this stock being owned by Hannevig was delivered to Hanssen as collateral security for a large indebtedness; and it was endorsed for transfer. Holding these certificates, Hanssen undoubtedly had the right to such a transfer and to the issue to him of new certificates in his name. The fact that the Delaware law requires that in such an instance it shall be noted on the entry of the transfer that it is for collateral security can make no difference. It does not lie in the mouth of this petitioner to object that Hanssen is not a stockholder of record when without right the petitioner itself has prevented him from becoming such.

Furthermore, it makes no difference whether he is a stockholder of record or not; he holds a large beneficial interest in the stock and the remaining interest of Hannevig is at most a naked legal title. The Delaware statute is a remedial statute and should be construed to afford the protection which it purports to afford, and it is apparent that such protection should be accorded to those who have the beneficial interest in the stock of the company.

It is uniformly held that the delivery of a certificate of stock transferred in blank passes the title to said stock as between the parties and constitutes the recipient thereof a stockholder regardless of a transfer on the books of the corporation.

In *Johnston* v. *Laflin*, 103 U. S., 800, at 804, this Court states:

> "But as between the parties to a sale, it is enough that the certificate is delivered with authority to the purchaser, or anyone he may name, to transfer it on the books of the company, and the price is paid."

In *National Bank* v. *Watsontown Bank*, 105 U. S., 217, at 221, this Court, in a case in which such certificates were delivered as collateral security, states:

> "As collateral security for the payment of their notes, discounted and held by the Cecil National Bank, and with the power to sell for the purpose of payment, the title passed by the delivery of the certificate, with the accompanying power of attorney."

In *Cushman* v. *Thayer Manufacturing Company*, 76 N. Y., 365, the Court of Appeals stated:

> "The delivery of the certificate, as between the owner and assignee, with the assignment and power endorsed, passes the entire legal and equitable title in the stock, subject only to such liens or claims as the corporation may have upon it."

In *Jones on Collateral Securities*, Third Edition, Section 168, occurs the following statement fortified by the citation of numerous authorities:

> "Whatever be the view taken of the necessity of a transfer upon the books of a corporation in order to protect the title of such assignee as against subsequent attaching creditors of the assignor, it is agreed that, as between the parties themselves, the title passes by indorsement and delivery of the certificate, without any entry of the transfer upon the books of the corporation; or even without filling up the transfer, where this has been signed in blank."

It is true that most of the cases hold that until a transfer is had upon the books of the corporation the stock will be subjected to any lien the corporation may have against the stock, but this is entirely immaterial and in this case it does not appear that there are any such liens. It must follow from the above decisions that when Hannevig delivered this stock to Hanssen with a

duly executed power of attorney to transfer it the title to the stock passed to Hanssen and constituted him a stockholder of the company, and, of course, as such he had a right to institute this suit.

It is apparent that the only persons interested in the property of a corporation are its stockholders and creditors and it is the manifest object of the statute to afford protection to anyone having a substantial right in the property of the corporation. Certainly, a pledgee of the securities of a corporation, both of its stock and its notes, the title to which is transferable by delivery, has such a substantial interest and should be protected under the statute.

A statute of New Jersey provides that after the insolvency of a corporation a receiver will be appointed upon the application of any "creditor or stockholder" and it has always been held under such statute that the beneficial owner of the stock can proceed.

In *Reinhardt* v. *Interstate Telephone Co.* (71 N. J. Equity, 70), the Vice-chancellor held that a stockholder could proceed although his stock stood in the name of the broker who purchased it for him.

In *O'Grady* v. *U. S. Telephone Co.* (71 Atlantic, 1040), the Court of Errors and Appeals of New Jersey under the same statute held that the owner of shares of stock of the defendant corporation could proceed although he had deposited those shares under a voting trust agreement which entitled the voting trustee to exercise all rights of every name and nature including the right to vote. It was specifically objected that the complainant was not a stockholder within the meaning of the statute. The court approves the *Reinhardt* case, *supra*, and states:

> "The right of O'Grady, therefore, to maintain this suit depends upon whether he is in equity the owner of the stock represented by the voting trust certificate which he holds. That he is such owner seems to us to be plain."

In *Green* v. *Hedenberg* (159 Ill., 489), the Supreme Court of Illinois held that a pledgee of stock could maintain a bill against a corporation for misappropriation of the corporate funds, and stated:

> "It is true, in this case complainant was only a stockholder by reason of his holding the 750 shares of stock as collateral security; but if, as alleged, that security was impaired by a misappropriation of the corporate funds, we see no reason, and none is even attempted to be shown, why he might not, as any other stockholder, maintain the bill. *Baldwin* v. *Canfield*, 26 Minn., 43, is in point."

It is further true that it is the duty of the holder of securities as collateral for a loan to do everything in his power to protect the value of such securities. It must follow that if a proceeding for the appointment of a receiver is necessary to the preservation of the value of the pledged securities, it is the duty of the pledgee to institute the proper proceedings therefor and the courts have frequently indicated such to be the law.

In *Warburton* v. *Trust Co. of America*, 169 Fed., 974, in speaking of collateral security, the Court said:

> "A bond or any chose in action which is transferred as collateral security is put under the dominion of the creditor to make his claim out of it. It is not in the nature of or subject to the incidents of a pawn or pledge. (*Muirhead* v. *Kirkpatrick*, 21 Pa., 241.)
>
> The Trust Company was required to employ reasonable diligence in the collection of any money which could be made on these securities, and especially so when the securities were obligations against an insolvent corporation passing through bankruptcy."

In *Gorman-Wright Co.* v. *Wright*, 134 Fed., 363, the Circuit Court of Appeals for the Fourth Circuit considered the status of a pledgee of stock and held that

such a pledgee had all the rights that the pledgor had in regard to seeking the aid of a court of equity to protect the property and the Court stated:

> "We think it beyond question that the pledgee of stock has such an equitable interest in it as will entitle him to be heard in a court of equity concerning its preservation, and the protection of his interests therein, to the same extent, at least, as the stockholder pledging it would have. 2 Thomp. Corp. Sec. 2657; 22 A. & E. Ency. of Law (2d Ed.) 907; 2 Kent's Com. (14th Ed.) 349. But while it is true that the pledgee of stock may sue in equity concerning it, with the same rights and privileges that the pledgor had, does it follow that the court below had jurisdiction of this case?"

The Court dismissed the above proceeding on account of the lack of requisite diversity of citizenship, but this does not affect the soundness of the above views.

It is, therefore, submitted that Hanssen was well within his rights in instituting these proceedings as a stockholder of The Pusey and Jones Company.

It is true that the courts below did not base their action on the fact that Hanssen was a stockholder, but that makes no difference if the fact exists. It was not a fact that would in any way enter into the discretion of the court in regard to the appointment of receivers. It simply bears on the question of whether the Court had power to act, but once having that power the considerations leading to the appointment of receivers would be the same whether the power was based on Hanssen's status as a creditor or a stockholder.

Certainly the objections that are raised to such a proceeding at the instance of a common creditor do not apply to one instituted by a stockholder, for the reason that the stockholder has no action at law whatsoever, and never did have. If he can get any protection for his rights it must be in equity and such protection always

has been afforded in equity. There is no way in which either he or the corporation could procure a jury trial in regard to his rights as a stockholder and therefore the Seventh Amendment does not apply and certainly it cannot be said that as a stockholder he has an adequate remedy at law. The long line of stockholders' suits that have been entertained by all courts, state and federal, demonstrate these propositions. This very situation here presented has arisen in the federal courts and the above principles have been vindicated.

In *Jacobs* v. *Mexican Sugar Co.* (130 Fed., 589), the complainants were stockholders of the defendant corporation and also creditors who had not reduced their claims to judgment. The proceeding was in the District Court for the District of New Jersey and was brought under the New Jersey statute which provides that "any creditor or stockholder" may proceed to obtain the appointment of receivers and other relief whenever any corporation becomes insolvent. The jurisdiction of the Court was contested upon the ground that it could not be enlarged by a state statute. The Court held that so far as the complainants were simple contract creditors without lien on the defendant's property, they had no standing to prosecute the bill, the state statute to the contrary notwithstanding (p. 591), the Court proceeding upon the authority of *Scott* v. *Neely* and other cases. After having so decided, the Court further held (p. 592):

> "But both of the complainants come also into court as stockholders with large interests, alleging the insolvency of the company and the maladministration of its affairs and the question is whether in that capacity they are entitled to be heard."

The Court then states that in the absence of statute there would be no general jurisdiction of the case, and add (p. 592):

> "But in the present instance there is such a statute and if the right to intervene which it confers is essentially equitable in character it is properly appealed to; and that it is, as it seems to me, there can be little doubt."

A receiver was appointed, the Court concluding its opinion as follows (p. 593):

> "But it is just at this point that the statute of the state steps in. By it a single stockholder, alleging the insolvency of the corporation and its inability to further carry on its business with safety to the public and advantage to those interested therein, may ask the intervention of the court to enjoin the exercise of its franchises and wind up its affairs. The court, where this course is taken, is thus put in possession of the case by one who has the undoubted right to invoke its jurisdiction, and the rest is a mere matter for the exercise of its recognized equity powers. The bill is therefore well brought, and must be sustained."

In the case of *Darragh* v. *Wetter Manufacturing Co.*, Circuit Court of Appeals, Eighth Circuit, 78 Fed., 7, under a similar statute the court not only upheld the right of a common creditor to proceed, but stated (p. 15):

> "If a creditor of another state could not proceed to wind up an insolvent corporation in the State of Arkansas without a judgment and an execution returned unsatisfied under this statute a stockholder of such a corporation certainly could, and the effect of such a holding would be to give a stockholder of an insolvent corporation a right to the sequestration of its assets superior to that of a creditor."

In *Kessler* v. *Wm. Necker, Inc.* (258 Fed., 654), a bill was brought under the New Jersey statute and, although the Court discusses with evident approval the cases which hold that a common creditor may proceed, it sus-

tained the bill and continued the receivership upon the following ground (p. 660):

> "It is not necessary, however, to sustain the bill on the ground that the complainants or any of them were simple contract creditors; all of them but two, one original and one intervening, were stockholders, and as such may maintain the action."

It is, therefore, submitted that this bill may properly be sustained on the ground that the complainant is a stockholder of the corporation, regardless of his status as a creditor.

Second: The intervention of the United States Shipping Board Emergency Fleet Corporation on October 8, 1921, injected a party that had a direct lien upon all of the valuable real estate owned by the petitioner.

Another reason why the questions involving the respondent's status as a creditor are not determinative is that by leave of the District Court the United States Shipping Board Emergency Fleet Corporation intervened as a party complainant and has a mortgage lien on all the real estate of the petitioner. It will not be disputed that the existence of such a direct lien gives equity jurisdiction for the appointment of receivers unhampered by the obstacles that sometimes confront common contract creditors. The status of such a lienor having been considered at all times a subject for equitable protection, the claim is not a legal one and consequently there is no right to a trial by jury, nor is there any adequate remedy at law which must be exhausted. Certainly, if this intervenor had been an original complainant these propositions would undoubtedly have been admitted, but it is claimed in the opposing brief that the proceedings were so defective that they could not be perfected by a

subsequent intervention. This contention is not sound for the reason that the lower court had full jurisdiction over the original parties and had jurisdiction over the subject matter of the proceeding, any defect in jurisdiction arising from the fact that the complainant had not reduced his claim to judgment being one that could be waived, and from the further fact that the proceeding was legitimately in court if for no other purpose than that of enforcing the transfer of the preferred stock to the complainant's name. The petitioner's contention in this behalf seems to be in effect that there was no proceeding and therefore none in which the Emergency Fleet Corporation could intervene. This is not the situation for the above reasons, if for no others.

It furthermore is not correct that a defect of jurisdiction arising from the lack of capacity of a party may not be cured by the intervention of a party properly qualified. It must be remembered that this was a class action, being brought for the benefit of all stockholders and creditors. In such an action if the original complainant cannot qualify the proceedings are perfected by the intervention of one of the prescribed class who can qualify.

Hanna v. *Lyon* (179 N. Y., 107).

The action was brought by one Hanna as a stockholder for the benefit of all stockholders, but it developed that at the time of the commencement of the action he had disposed of his stock and therefore was not a stockholder. The Court of Appeals of New York, however, pointed out that a properly qualified intervenor had come in after the action had been begun and that cured the defect.

None of the cases cited in the opposing brief on page 6 on this subject control that question. No one of them was a class bill.

Rouse v. *Letcher* (156 U. S., 47), simply decided that a judgment on a claim to intervene is a final judgment.

Adler v. *Seaman* (266 Fed., 828), simply decided that the court will not force a party to intervene by the devise of consolidating actions.

The Pennsylvania case simply decides that an intervenor is bound by the previous conduct of the suit.

The Georgia case contains no opinion, but it appears that the facts set forth in the intervening petitions showed no right to intervene.

The case of *Boston & M. R. R.* v. *Sullivan* (275 Fed., 890), simply holds that after receivers have been appointed a claimant, who has a claim for negligence, is not entitled to a jury trial.

POINT IV.

The federal Court has jurisdiction in equity to appoint a receiver under the Delaware statute at the instance of a simple contract creditor.

If, however, the Court considers it essential to the disposition of this case to pass upon the question of whether a creditor who has not reduced his claim to judgment can proceed on the equity side of the District Court of the United States to procure the relief provided for in the statute, we submit that the power undoubtedly exists in that Court so to proceed.

This question, so far as we have been able to discover, has never been passed upon by this Court and we fully realize the importance of the principles involved and the consequences that may flow from a decision of the question, whatever it may be. It is a question that cannot be disposed of by the simple method of calling the bill filed herein a creditor's bill for the collection of a debt and citing the case of *Scott* v. *Neely* that dealt with such a proceeding.

As Judge WOOLLEY remarked in the Circuit Court of Appeals in this case (279 Fed., at p. 492), the State Court of Chancery in Delaware and the federal courts in the District of Delaware for decades have undertaken to proceed under this statute in the administration of the affairs of insolvent corporations organized in the State of Delaware.

It is also true that in many of the other circuits similar jurisdiction has been exercised for a long period with the full approval of the Circuit Courts of Appeal in the circuits involved.

The propriety and the practical value of the exercise of such jurisdiction, increasingly important with the ever-growing complexity of corporate ownership and the great augmentation of business done by and property owned by corporations, is not only recognized but fully emphasized by the expression of public policy on the part of numerous States which have seen fit to pass statutes more or less similar to the one here involved with the idea of conferring this jurisdiction upon the courts of equity in their respective jurisdictions. Such statutes now exist in many States, among others in New Jersey, Illinois, Louisiana, Massachusetts, North Carolina and West Virginia. There is no indication that any of these States have found this policy an unwise one.

Nor will it be questioned in this Court that the privilege of invoking the aid of a federal court, instead of a state court, is a valuable privilege.

From these considerations it must be apparent that if this control over the administration of the affairs of an insolvent corporation has been based upon a misconception of the meaning of the Constitution of the United States and of the decisions of this Court, the consequences will be far reaching. If it is the law that a creditor, no matter how large his claim against a corporation may be, no matter how evident it may be that it is a just claim, must spend a protracted period in going through

the form of obtaining a judgment at law, and the return of an execution *nulla bona* before he can invoke the equitable jurisdiction of the federal courts to protect the corporate property in which he is so largely interested from dissipation and depredations always incident to insolvency, it is but another way of stating that his rights are precarious in the extreme. We reiterate that no such result can be predicated upon any decision yet made by this Court.

The fallacy that runs through the entire argument, so at length presented by our opponents, quite evidently is that they consider this a proceeding for the collection of a debt and strangely enough, after vigorous protests to the effect that they are being deprived of a jury trial, in a later portion of their argument and in another connection, they state:

> "It is apparent upon mere inspection of the bill that *no final relief whatsoever is prayed for with respect to Hanssen's alleged rights as a creditor.* There is no prayer for judgment upon the alleged claim. There is no demand that the claim be impressed upon the Company's property as a lien, or that its property be sold to provide means of payment." (Opposing brief, p. 37.)

The principles enunciated by this court with ever-increasing clearness that underlie the question here involved are plain. If any difficulty exists in this case, it arises not from any doubt as to what those principles are, but from a difficulty in applying them.

We do not contend that the distinctions between equitable procedure and legal procedure in the federal courts can be abrogated by a state statute; nor do we claim that a state statute by the device of creating an equitable remedy to enforce a purely legal right can

thereby enlarge the equitable jurisdiction of a federal court; nor do we claim that a state statute can create a new right essentially legal in its character and by calling it an equitable right, or by providing that it shall be enforced in a court of equity, empower a federal court to proceed in its enforcement on the equity side.

We do, however, claim that from the foundation of the federal courts it has been well recognized that the subjects of the equity jurisdiction of and the equitable remedies administered by, the federal courts are not static, but are ever-increasing, both in regard to substantive rights which will be vindicated and in regard to the complexity and variety of remedies that will be applied.

We, therefore, base our contention upon the proposition that this statute of Delaware created a new right, one which did not before exist, that the right so created is essentially equitable in its nature and that it provided that such right should be enforced by a remedy that is among the most ancient applied by the Court of Chancery. On this basis we maintain that the jurisdiction should be upheld.

The above propositions have been laid down in many cases decided by this Court.

In *Scott* v. *Neely* (140 U. S., 106), a case that is the bulwark of our opponents' position, the Court nevertheless states:

> "The general proposition, as to the enforcement in the Federal courts of new equitable rights created by the States, is undoubtedly correct, subject, however, to this qualification, that such enforcement does not impair any right conferred, or conflict with any inhibition imposed, by the Constitution or laws of the United States."

After having stated in *ex parte McNiel* (13 Wall., 236), that

> "This principle may be laid down as axiomatic in our National jurisprudence; a party forfeits nothing by going into a federal tribunal;"

and in *Davis* v. *Gray* (16 Wall., 203), at page 221, that

> "A party by going into a National court does not lose any right or appropriate remedy of which he might have availed himself in the state courts of the same locality. The wise policy of the Constitution gives him a choice of tribunals."

this Court said in *Broderick's Will* (21 Wall., 503), at page 520:

> "Whilst it is true that alterations in the jurisdiction of the State courts cannot affect the equitable jurisdiction of the Circuit Courts of the United States, so long as the equitable rights themselves remain, yet an enlargement of equitable rights may be administered by the Circuit Courts, as well as by the courts of the State."

This same principle has been carried down through many cases and this Court in *Louisville & Nashville Railroad* v. *Western Union Telegraph Co.* (234 U. S., 369), set out the following principles in discussing a statutory enlargement of equitable rights:

> "There are many state statutes of this type and our decisions show that their enforcement in the Federal courts is subject to but three restrictions (1) the case must be within the general class over which those courts are given jurisdiction; (2) a suit in equity does not lie in those courts where there is a plain, adequate and complete remedy at law; (3) in those courts there can be no commingling of legal and equitable remedies or substitution of the latter for the former, whereby the constitutional right of trial by jury in actions at law is defeated."

In *Greeley* v. *Lowe* (155 U. S., 58, at p. 75) this Court stated:

> "This court has held in a multitude of cases that where the laws of the particular State gave a remedy in equity, as for instance, a bill by a party in or out of possession, to quiet title to lands, such remedy would be enforced in the Federal courts, if it did not infringe upon the constitutional rights of the parties to a trial by jury."

It, therefore, becomes apparent that if this Delaware statute creates a new right of an equitable nature or recognizes and enlarges an equitable right already existing and affords a remedy consistent with the practice in equity, it will be enforced in the federal courts.

On the other hand, it is equally apparent from these principles that a state statute attempting to confer on a court of equity power to enforce a right that is legal in its nature and for the enforcement of which there is a complete and adequate remedy at law would be ineffective to empower the federal courts to proceed to apply such an equitable remedy. No better illustration of such an attempt can be found than the one discussed in *Whitehead* v. *Shattuck* (138 U. S., 146), which involved an Iowa statute providing for an equitable action to quiet the title to land as against a person in possession thereof. This court pointed out that the action of ejectment afforded a full and complete remedy at law and, therefore, the statute was but an attempt to provide an equitable remedy for a situation that was strictly legal.

Another illustration of the same kind of a statute is involved in the case of *Scott* v. *Neely, supra.* There the statute of Mississippi provided that a creditor without having obtained a judgment at law could exhibit a bill to set aside fraudulent conveyances of property and to subject the property to the satisfaction of the debt, and should have a lien as against the world with the exception

of *bona fide* purchasers before the service of the process. In short, this was a statute authorizing a creditor to collect his debt in equity, and again the court held that the jurisdiction of the federal courts in equity could not be so enlarged, as the complainant had a complete and adequate remedy at law.

It follows that the only inquiry here is whether this Delaware statute creates a new right or remedy equitable in character applicable to a situation for which there was no adequate and complete legal remedy.

(1) The Delaware statute creates a new right, namely, the right to a receivership solely upon the insolvency of a corporation.

The language of the Delaware statute in this regard is as follows:

> "Whenever a corporation shall be insolvent the Chancellor, on the application and for the benefit of any creditor or stockholder thereof, may at any time in his discretion appoint one or more persons to be receivers of and for such corporation," etc.

Although there may be isolated cases in which some courts have appointed receivers of corporations solely on the ground of insolvency, they do not represent the almost universal practice of courts of equity on that subject.

There are frequent cases in which insolvency, coupled with other conditions, such as a dissipation of funds, mismanagement on the part of directors, public interest and other circumstances, has been held sufficient to justify a receivership, but these cases do not proceed upon the condition of insolvency alone.

In *Tardy's Smith on Receivers,* Section 17, it is stated:

"Mere insolvency of the defendant without any other grounds being stated as a cause of action, will not be sufficient for the appointment of a receiver by a court of equity in the absence of a statute allowing the appointment upon a showing of insolvency or imminent danger of such a condition.

Insolvency is, however, most frequently one of several reasons for the appointment of a receiver, but insolvency as a ground for the appointment of a receiver is predicated upon the general doctrine of probable loss; hence, there must be coupled with an allegation of insolvency additional allegations showing the plaintiff's right of recovery or probability of recovery and that such recovery will be wholly or substantially lost or impaired by reason of the insolvency."

In *High on Receivers*, Section 18, it is stated:

"While insolvency of a defendant in possession and against whom a receiver is sought is frequently relied upon by the courts as a ground for granting relief, it is to be observed that insolvency will not of itself warrant a court in appointing a receiver. It must also appear that plaintiff has a probable cause of action against the defendant, and that the benefit to result from his recovery will either be wholly lost or substantially impaired by reason of such insolvency, unless a receiver is appointed."

In re Metropolitan Railway Receivership (208 U. S., 90), indicates that even where public interest and other circumstances showing imminent danger of dissipation of the defendant corporation's property were involved, a receiver would not be appointed except upon the consent of the defendant.

That this right to a receivership upon the sole ground of insolvency is a new right is also clearly indicated in the exhaustive opinion of Judge Bradford in *Jones* v.

Mutual Fidelity Co. (123 Fed., 506), a case arising under this Delaware statute.

The right to a receivership is a substantial right and oftentimes constitutes the only means of saving both the creditors and stockholders immense values in the possession of insolvent corporations. The argument that no such relief is permissible as the only and ultimate relief prayed for in a proceeding, is sufficiently answered by reference to the many cases in the federal courts in which that relief only has been requested and granted.

That the right thus created is a right of an equitable nature cannot be successfully disputed. This Court has frequently held that the property of a corporation is of the nature of a trust fund for the benefit of the creditors and stockholders of the corporation, and although something more must appear before the Court will undertake to administer such a trust, yet, when the Court has once taken the property into its possession all the incidents of such fiduciary relationships arise.

In *Hollins* v. *Brierfield Coal & Iron Co.* (150 U. S., 371), Mr. Justice Brewer, after discussing some of the cases on this subject, states in reference to one of them:

> "All that it decides is that when a court of equity does take into its possession the assets of an insolvent corporation it will administer them on the theory that they in equity belong to the creditors and stockholders, rather than to the corporation itself. In other words, and that is the idea which underlies all these expressions in reference to 'trust' in connection with the property of a corporation, the corporation is an entity distinct from its stockholders as from its creditors. * * * Becoming insolvent, the equitable interest of the stockholders in the property, together with their conditional liability to the creditors, places the property in a condition of trust, first, for the creditors, and then for the stockholders."

This is sufficient to indicate that the administration of the property of an insolvent corporation, if it is once properly taken possession of by the Court, is equitable and not legal in its nature.

That the remedy provided by the Delaware statute is also equitable in its nature is manifest. There is no remedy longer peculiar to equity than the remedy of receivership.

In *Williamson* v. *Wilson* (1 Bland's Chancery, Md., 418), decided in 1826, it was stated in reference to this remedy:

> "It is a power of the Court of Chancery of England which appears to have been very frequently called into action during more than a century past. All the leading principles in relation to it were well established there long before our Revolution and it was then and has ever since been considered there and here as a power of as great utility as any which belongs to a court of chancery, and that it is so will appear very evident from a review of the nature and the variety of the exigencies in which it has been called into action either to prevent fraud, to save the subject of litigation from material injury, or to rescue it from inevitable destruction."

We, therefore, submit that the Delaware statute in question creates a new equitable right and affords therefor an equitable remedy. For these reasons the federal court sitting in equity is fully empowered to enforce its provisions.

(2) The District Court in the District of Delaware has proceeded for many years upon the above principles in the enforcement of this statute.

Oftentimes despite objections based upon the same contentions that are now made by the petitioner, the District Court of the United States for the District of

Delaware has for years proceeded to enforce the statute in question upon the principles above laid down. Instances thereof are to be found in the following cases:

Wheeler v. *Walton & Whann Co.* (64 Fed., 664);
Maxwell v. *Wilmington Dental Manufacturing Co.* (82 Fed., 214);
Jones v. *Mutual Fidelity Co.* (123 Fed., 506);
Hitner v. *Diamond State Steel Co.* (176 Fed., 384);
Adler v. *Campeche Laguna Corporation* (257 Fed., 789);
Spackman v. *Swan Creek Co.* (274 Fed., 107);
Hanssen v. *Pusey & Jones Co.* (the case at bar), (276 Fed., 296).

The only case in which the Circuit Court of Appeals for the Third Circuit has passed on this particular statute is in the case at bar (279 Fed., 488).

In some of the above cases the application was made by a simple contract creditor; in others by a stockholder and in some by both.

The most exhaustive opinion upon the subject is that of Judge Bradford, in *Jones* v. *Mutual Fidelity Co., supra,* an opinion in which he reviews many cases on this subject and discusses the principles involved at length. The suit was brought by a simple contract creditor and was heard on demurrer, but at the hearing the principal objection urged was that the complainant was a creditor who had not reduced his claim to judgment. The Court states at page 516:

> "The demurrer does not assign as a cause that it does not appear that the complainants have obtained judgment on their claim. This objection, however, was at the hearing made *ore tenus* in support of the demurrer and also was discussed

in the briefs of counsel. Under these circumstances the objection thus made should be treated in the same manner as if formally assigned in the demurrer."

The Court then proceeds at great length to discuss the objection, and the following quotations from the opinion will indicate that the Court proceeded upon the principles we have endeavored to state.

> "The Delaware statute in conferring on the Chancellor authority, solely on the ground of insolvency, to appoint receivers for insolvent corporations and take possession of and fully and finally distribute their assets, provided a purely equitable procedure for the enforcement of equitable rights on the part of creditors and stockholders" (p. 517).

Further:

> "Under the settled construction of the Act its provisions apply as well to general and unsecured creditors as to creditors whose claims have been reduced to judgment or otherwise judicially ascertained, or are admitted" (p. 517).

The Court then points out that neither the federal court in Delaware nor the state court, in the absence of said statute, could appoint a receiver on the sole ground of insolvency, and then states:

> "While a state law cannot confer jurisdiction on any federal court it may create a substantial right which the proper federal court otherwise possessing jurisdiction may enforce by a proper remedy whether in equity or admiralty, or at law" (p. 517).

After referring to the constitutional right to a trial by jury and the federal statute prohibiting a proceeding in equity where there is an adequate remedy at law and

admitting that legal and equitable procedure may not be blended in a federal court, it is stated:

> "And where a state statute creates a right and a remedy for its protection or enforcement and such remedy substantially conforms to the procedure in chancery, it, in the absence of a plain, adequate and complete remedy at law, may be pursued on the equity side of the federal court" (p. 518).

The Court then reviews many cases decided by this Court in support of the above propositions and bearing on the question of what is an adequate and complete remedy at law, and admits that

> "Where the direct object of a suit is the judicial ascertainment of the existence and amount of a pecuniary legal demand and the enforcement of its payment by the process of the court in which the suit is brought, the proceeding is essentially an action at law and in a federal court must be so treated regardless of state legislation" (p. 521).

and refers to the cases of *Cates* v. *Allen* (149 U. S., 451) and *Scott* v. *Neely, supra,* stating that they are in that class, and remarks:

> "There is a clear distinction between the exercise of equitable jurisdiction in aid of a legal remedy for the collection of a pecuniary legal demand, and the exercise of equitable jurisdiction in enforcing a purely equitable right by a purely equitable remedy, created by a valid state statute, not in aid of any legal remedy, but wholly independently thereof, though the existence of such equitable right and remedy may presuppose and be dependent on the existence of such pecuniary legal demand. Failure to recognize this distinction has produced some confusion in the cases" (p. 522).

and further

> "Where equitable rights and remedies under a statute, founded on or bearing relation to pecuniary legal demands, would be defeated by ex-

hausting the remedy at law on such demands, such equitable remedies cannot be considered as in aid of the legal remedy. Under such circumstances an exhaustion of the legal remedy would practically nullify the remedy in equity, and therefore, if force should be given to the statute, it would be not only unnecessary, but improper, before proceeding thereunder to exhaust the legal remedy. * * * Being a purely equitable proceeding, the constitutional guaranty of jury trial would, of course, have no application" (pp. 522-23).

Further:

> "To authorize the appointment of a receiver two things only must be made to appear to the chancellor, namely, that the complainant is a creditor of the corporation and that the corporation is insolvent. If the corporation be shown to be insolvent, no judicial ascertainment of the amount of the pecuniary demand of the complainant is a prerequisite to the appointment of a receiver" (p. 524).

and the Court further remarks:

> "It is merely the fact that he is a creditor and not the amount of his demand that must appear to the court" (p. 524).

Further:

> "The broad object of the statute is that, in the discretion of the court, the affairs and assets of an insolvent corporation, not included in the exception, may be controlled, managed and disposed of by the Court through a receivership for the benefit of creditors and stockholders; and this object is to be attained, according to the circumstances and exigencies of different cases, either by a temporary assumption by the court of the custody and management of the corporate affairs and assets, or by a complete administration of such affairs and a final distribution of such assets. The statute has thus created and conferred on simple contract creditors as well as judgment

creditors a substantial right of a purely equitable nature and a purely equitable procedure to enforce it. No action at law by a non-judgment creditor nor any legal process on behalf of a judgment creditor, can enforce such a right" (p. 524).

Further:

"An application of the assets of the insolvent corporation to final process at law would be destructive of the right conferred by the statute" (p. 525).

The Court then points out that the statute involved in *Scott* v. *Neely, supra,* and *Cates* v. *Allen, supra,* had no such object in view and that it was simply intended to enforce in equity the payment of a particular legal demand. After discussing these cases and the case of *Hollins* v. *Brierfield Coal & Iron Co., supra,* it is stated:

"But I know of no case in which the proposition, either in terms or in substance, has been advanced that, where the object of the suit is the enforcement of a substantial right in equity created by a state statute, and the exhaustion of a legal remedy would necessarily defeat the object of the suit, such legal proceeding would furnish a plain, adequate and complete remedy for attaining the object of the suit" (p. 527).

The Court reviews cases under analogous statutes, passed upon by other federal courts and concludes that the Delaware statute is clearly a statute which creates a substantial equitable right and furnishes an equitable remedy and, therefore, can properly be enforced in a federal court on its equity side.

These propositions have been adopted by the Circuit Court of Appeals in the Third Circuit in the case at bar, which is now here for review.

In *Adler* v. *Campeche Laguna Corporation, supra,* the Court states (p. 791):

"The Delaware statute enlarges the jurisdiction of the court of chancery over the appointment of receivers for corporations to include cases where insolvency is the sole ground for the appointment. It not only creates the right but designates the persons entitled to the relief."

(3) Many of the Circuit Courts of Appeal have upheld similar statutes.

In *Darragh* v. *H. Wetter Manufacturing Company* (78 Fed., 7) the Circuit Court of Appeals for the Eighth Circuit considered certain statutes of the State of Arkansas which provided that any creditor or stockholder of an insolvent corporation might institute proceedings in the Chancery Court for winding up its affairs, and upon such application the court would take charge of the assets of the corporation and distribute them among the creditors, etc.

The bill was brought by a simple contract creditor who had not obtained judgment, the only basis for the proceeding being that the defendant corporation was insolvent. The same objection to the jurisdiction of the court that is involved in this proceeding was urged, and Judge SANBORN considers the matter at length. He points out that *Scott* v. *Neely, supra,* and *Cates* v. *Allen, supra,* involve a statute that created no new rights nor provided new remedies, but simply changed the rules of practice in equity. After a review of many cases, he concludes that the following principles are firmly established in the jurisprudence of the United States (p. 14):

"Rights, created or provided by the statutes of the states to be pursued in the state courts may be enforced and administered in the federal courts, either at law, in equity, or in admiralty, as the nature of the new rights may require. *Ex parte McNiel,* 13 Wall., 236; *Cummings* v. *Bank,* 101 U. S., 153, 157; *Trust Co.* v. *Krumseig* (decided by

> this court at May term, 1896). 77 Fed., 32. An enlargement of equitable rights by the statutes of the states may be administered by the national courts as well as by the courts of the states. Case of *Broderick's Will*, 21 Wall., 503. 520; *Clark* v. *Smith*, 13 Pet., 195, 202; *Holland* v. *Challen*, 110 U. S., 15, 25, 3 Sup. Ct., 495; *Frost* v. *Spitley*, 121 U. S., 552, 557, 7 Sup. Ct., 1129; *Reynolds* v. *Bank*, 112 U. S., 405, 5 Sup. Ct., 213; *Chapman* v. *Brewer*, 114 U. S., 158, 170, 171, 5 Sup. Ct., 799; *Gormley* v. *Clark*, 134 U. S., 338, 348, 349, 10 Sup. Ct., 554; *Bardon* v. *Improvement Co.*, 157 U. S., 327, 330, 15 Sup. Ct., 650; *Cowley* v. *Railroad Co.*, 159 U. S. 569, 583, 16 Sup. Ct., 127. 'A party, by going into a national court, does not lose any right or appropriate remedy of which he might have availed himself in the state courts of the same locality.' *Ex parte McNiel*, 13 Wall., 236; *Davis* v. *Gray*, 16 Wall., 203. 221; *Cowley* v. *Railroad Co.*, 159 U. S., 569, 583, 16 Sup. Ct., 127."

The Court further states (p. 15):

> "Creditors and stockholders had no right, without such a statute, to have a receiver of a corporation appointed, to have its property sold, and to have its proceeds distributed pro rata among its creditors, simply because it was insolvent. The statute created that right."

It is true that the court pointed out certain provisions in the Arkansas statute which seemed to modify the effectiveness of the legal remedy possessed by a creditor, but the decision is principally based upon the ground above mentioned.

In *McGraw* v. *Mott* (179 Fed., 646) the Circuit Court of Appeals for the Fourth Circuit considered the New Jersey statute, which provided that when a corporation is insolvent "Any creditor or stockholder may by petition or bill of complaint" set out the facts and apply to the Court of Chancery for an injunction and the appointment of receivers.

The jurisdiction of the Court was challenged on the same grounds heretofore discussed. The Court states (p. 651):

> "It is urged that the court was without jurisdiction because the complainant had not reduced his claims to judgment in a court of law; that he had a complete and adequate remedy at law by obtaining judgment on his debts against the defendant corporation and suing out execution against its property."

After referring to a number of cases the Court states (p. 653):

> "Without entering into an extended discussion of the decisions, we reach the conclusion that in view of the construction put upon the statute by the Supreme Court of New Jersey and its evident purpose, it is not essential to the jurisdiction of the Circuit Court of the United States that the complainant shall be a judgment creditor or have a specific lien on the corporate property."

In *Land Title & Trust Company* v. *Asphalt Company of America* (127 Fed., 1) the Circuit Court of Appeals for the Third Circuit considered the same New Jersey statute.

The complainant had a lien on some of the property of the defendant corporation, and, therefore, the Court did not find it necessary directly to decide the question of the right of a simple contract creditor to proceed in a federal court of equity, but nevertheless made the following statements (p. 18):

> "It is true that, independent of statutory authority, the general equitable jurisdiction of the United States courts does not extend so far as to entertain a suit by a creditor against a corporation, seeking the appointment of a receiver of its business and property and an injunction against the exercise of its corporate franchises,

solely on the ground of insolvency. It is, however, well settled by adjudications of the Supreme Court and subordinate federal courts, that if a state legislature, by a valid law, create a right essentially equitable in its nature, prescribing a remedy for its enforcement substantially consistent with the ordinary modes of proceeding on the chancery side of the federal courts, no reason exists why it should not be pursued in a federal court of equity in the same form as it is in the state courts."

In *Kessler* v. *William Necker, Inc.* (258 Fed., 654), the District Court of New Jersey again considered the New Jersey statute. The bill was brought by simple contract creditors who were also stockholders, and although the Court discussed the question involved the decision seems to be based upon the ground that the complainants were stockholders as well as creditors, and that the defendant corporation had waived any objection to the jurisdiction. The Court, however, does quote with approval the cases of *Darragh* v. *H. Wetter Manufacturing Company, supra*, and *Jones* v. *Mutual Fidelity Company, supra*.

In *Lion Bonding and Surety Company* v. *Karatz* (280 Fed., 532), decided in April, 1922, the Circuit Court of Appeals for the Eighth Circuit, in the absence of a statute, appointed receivers at the instance of complainants who were simple contract creditors and against an objection upon that ground. In this regard the Court says (p. 537):

> "The second assignment of error, that the plaintiff is not entitled to the equitable relief of appointment of receivers, as he is only a simple contract creditor, without having reduced his claim to a judgment and exhausted his remedy at law, is equally without merit. The facts alleged in the complaint, and which are admitted, are that the company is wholly insolvent, and its property in danger of loss and dissipation by reason of seizures under execution and attachments, and

waste, to the great loss of the creditors, justified the action of the District Court to appoint receivers, without the necessity of useless proceedings at law. *Williams* v. *Adler-Goldman Comm. Co.*, 227 Fed., 374; 142 C. C. A., 70 (8th Ct.), affirming (D. C.) 211 Fed., 530, and authorities cited in the opinions of this case. As said in *Case* v. *Beauregard*, 101 U. S., 688; 25 L. Ed., 1004, on like contentions: 'Neither law nor equity requires a meaningless form. "*Bona, sed impossibilia, non cogit lex.*" It has been decided that, where it appears by the bill that the debtor is insolvent and that the issuing of an execution would be of no practical utility, the issue of an execution is not a necessary prerequisite for equitable interference.' "

This case is an instance of the propriety of a receivership upon the allegation of insolvency accompanied by allegations that the property is in danger of loss and dissipation.

The statutes considered in the foregoing cases all relate to insolvent corporations, and those courts have been convinced that statutes similar to the statute of Delaware are properly enforceable in the federal courts.

(4) Cases in the lower courts cited by petitioner.

The petitioner cites eight cases in the federal courts claimed to be authority for an opposite conclusion. (Brief p. 17.) Many of these cases do not apply and an examination of those which possibly are pertinent will disclose the fact that they proceeded upon the doctrine of *stare decisis*. They simply state that the situation is governed by the cases of *Scott* v. *Neely*, *Cates* v. *Allen* or *Hollins* v. *Brierfield Coal & Iron Company*, thus begging the question which is now before this court.

The first case is *United States* v. *Sloan Ship Yards Corporation* (270 Fed., 613) District Court, State of

Washington. The complainant held a mortgage lien on the defendant's property, but despite this fact the court dismissed the bill evidently on the ground that a receivership was not final relief and that a simple contract creditor could not sue under the authority of *Hollins* v. *Brierfield Coal & Iron Company.*

It is difficult to see how the case was properly decided in view of the above facts.

The next case is *Davidson-Wesson Implement Co.* v. *Parlin & Orendorff* (141 Fed., 37). In this case the Circuit Court of Appeals for the Fifth Circuit dismissed the bill with a short opinion relying upon the case of *Scott* v. *Neely.* A Louisiana statute was involved which is elaborate in its provisions, providing for receiverships in various situations, sometimes upon an application of stockholders, sometimes of creditors and sometimes of judgment creditors. If the application is on account of insolvency the statute provides that the complainant must be a judgment creditor. The bill alleged that all the defendants were insolvent. It is possible, therefore, that the complainant did not come within the terms of the statute, although it is further true that other sections of the statute provide that a simple contract creditor can apply where the property has been diverted from corporate purposes, and there were such allegations in the bill. The court designates the bill as a creditor's bill, which seems to be correct as it asked for a judgment for the amount of a debt due the complainant, and for a receivership. Under such a prayer it is possible that the proceeding is governed by the authority of *Scott* v. *Neely.*

The next case is *Jacobs* v. *Mexican Sugar Company* (130 Fed., 589). The complainants were stockholders and one of them was a simple creditor. The bill alleged that the defendant corporation was insolvent and that certain preferences had been created, and prayed for a receiver and that the rights of the complainant creditor

and all other creditors should be ascertained and their claims enforced. The bill was based on the New Jersey statute. Judge ARCHBALD in the District of New Jersey held, on the authority of *Hollins* v. *Brierfield Coal & Iron Company*, that so far as the complainant creditor was concerned there was no jurisdiction. This holding is, of course, at variance with the holding of the Circuit Court of Appeals for the Third Circuit. The court, however, further held that the complainants could proceed as stockholders under the New Jersey statute and, therefore, appointed a receiver.

The next case is *Harrison* v. *Farmers' Loan & Trust Co.* (94 Fed., 728). In this case the Circuit Court of Appeals for the Fifth Circuit disposed of the proceeding in a very short opinion which does not disclose the facts, except that the complainants were simple contract creditors. The court states that they cannot come into equity to obtain a seizure of defendant's property and its application to the satisfaction of their claims, notwithstanding the fact that a state statute may authorize such procedure, basing the holding upon *Scott* v. *Neely* and like cases. It seems apparent that this also was strictly a creditor's bill to obtain payment of the particular debts in question.

The next case is *D. A. Tompkins Co.* v. *Catawba Mills* (82 Fed., 780). No state statute is involved and, therefore, the case does not apply.

The next case is *Morrow Shoe Company* v. *New England Shoe Company* (57 Fed., 685). This case was decided by the Circuit Court of Appeals for the Seventh Circuit and considered the Illinois statute authorizing the appointment of receivers at the instance of general creditors. The court admits that where a new right is created by a state statute the federal courts will enforce it according to its nature, but, on the authority of *Hollins* v. *Brierfield Coal & Iron Company*, held that this

particular statute could not be enforced in equity in the federal courts. This case is distinguished by Judge BRADFORD in *Jones* v. *Mutual Fidelity Company*, heretofore discussed. The court disposed of the proposition involved in the following brief remark (p. 698):

> "The bill fails to allege that the plaintiff had prosecuted its claim to judgment, and had issued an execution thereon, and had the same returned *nulla bona*. For this reason the bill of complaint is insufficient within the doctrine of *Scott* v. *Neely*, 140 U. S., 106, 11 Sup. Ct. Rep. 712, and *Cates* v. *Allen*, 149 U. S., 451, 13 Sup. Ct. Rep., 883, 977."

The next case is *Atlanta & F. R. Co.* v. *Western Railway Co.* (50 Fed., 790). The proceeding was brought by three general creditors and the Circuit Court of Appeals for the Fifth Circuit dismissed the bill on the authority of *Scott* v. *Neely*. It is somewhat doubtful whether any statute was involved, as it appears that although counsel had claimed there was a Georgia statute the court had been unable to find it. In the absence of the provisions of the statute involved it is difficult to determine the bearing to this case.

The last case cited is *Mathews Slate Co.* v. *Mathews* (148 Fed., 490). This proceeding was brought against two individuals under a Massachusetts statute, which authorized a creditor to proceed in equity to reach property that could not be reached by legal process. Relying upon *Cates* v. *Allen* the Circuit Court in Massachusetts held that it had no jurisdiction. It is apparent that this was a pure creditor's bill seeking to obtain the payment of a particular debt by the enforcement of the demand against property, that could not be reached at law, and possibly may be governed by *Scott* v. *Neely* and *Cates* v. *Allen*.

A review of these cases relied upon by the petitioner shows that they add nothing to the discussion. Those

that apply at all simply rely upon the cases of *Scott* v. *Neely*, *Cates* v. *Allen* and *Hollins* v. *Brierfield Coal & Iron Company*, which we maintain in no way govern this question.

(5) The complainant had no adequate remedy at law and the decision affording him relief was correct.

After having examined the utterances of the lower courts on statutes more or less similar to the Delaware statute, we are forced back to the question of whether or not the statute creates a new equitable right and whether or not the complainant had a full and adequate remedy at law.

That the statute creates a new equitable right and remedy seems to be apparent.

That the complainant had no remedy at law, let alone a complete and adequate one for the relief he sought, is also true. He could have proceeded to procure a judgment for large amounts against the defendant corporation and have called upon the sheriff to levy on any property that could be found, and in the absence of such property to make a return *nulla bona*, but such a course of conduct would clearly not afford him the relief he seeks in this action, but on the contrary would directly defeat it, because the result of such conduct would be to strip the corporation defendant of its property and put it into a situation where it had no property upon which a receivership could act. Therefore, the complainant, together with any other creditors of the defendant corporation and all of its stockholders, would have been deprived of the very valuable right of the continuance of a large going concern under the protection of the Court for the purpose of determining in the first instance whether the defendant could not be so regulated as to be able to go on with its business, or failing that, to insure a general and equitable distribution of its assets. No

process known to the law could accomplish these, or any of these objects, but on the contrary would either defeat them or in a large measure tend to defeat them.

As we have pointed out before, we have been unable to discover any case in this Court that passes on any statute relating to the administration of the affairs of an insolvent corporation by a court of equity.

The reliance of the petitioner seems to be upon the three cases of *Scott* v. *Neely; Cates* v. *Allen* and *Hollins* v. *Brierfield Coal & Iron Co., supra.*

The *Hollins* case is not in point, as no statute authorizing the procedure therein involved existed. Three unsecured creditors brought the proceeding against the defendant corporation asking that certain conveyances be set aside; that a receiver be appointed and "the property sold in satisfaction of their claims and that such receiver have authority to collect the unpaid stock subscriptions to be applied also in satisfaction of their claims."

Mr. Justice Brewer pointed out that the complainants were simple contract creditors and stated (p. 379):

> "It is the settled law of this court that such creditors cannot come into a court of equity to obtain the seizure of the property of their debtor and its application to the satisfaction of their claims and this, notwithstanding a statute of the State may authorize such a proceeding in the courts of the State."

The statement in regard to a state statute is *obiter*, as no statute is involved in the proceeding and the meaning of such dictum based as it is on the other two cases of *Scott* v. *Neely*, and *Cates* v. *Allen*, must be referred to those cases.

The case certainly does not involve any statute authorizing the administration of the affairs of an insolvent corporation.

Turning then to *Scott* v. *Neely* and *Cates* v. *Allen*, the other two cases relied upon, it will appear that they both relate to the same statute and that each case involved strictly a creditor's bill, seeking in a single proceeding to procure a judgment on a legal claim, to set aside fraudulent conveyances and to apply the proceeds of the property thus reached to the payment of the particular indebtedness of the complainant, and this against all other creditors.

A creditor's bill is properly defined as follows:

> "A bill by which a creditor seeks to satisfy his debt out of some equitable estate of the debtor which is not liable to levy and sale under execution at law, or out of some property which has been put beyond the reach of the ordinary process."
>
> Cyc., Vol. 12, page 5.

From time immemorial the principles surrounding such a proceeding have been technical and fixed. Long before the organization of our Government it was required in such instances in England that a creditor must first exhaust his remedy at law by procuring a judgment and the return of an execution *nulla bona* upon the theory that such a remedy was full and adequate. After having so proceeded, he could then bring a proceeding in equity to reach equitable assets and remove obstacles in the way of the collection of his judgment, the whole object of these proceedings being to satisfy the debt in question.

These principles were adopted in their entirety in the jurisprudence of this country, both state and federal, and the procedure became so technical that not only must the complainant obtain a judgment, but he must obtain a judgment in the particular state or district in which he proposes to bring his subsequent bill to remove the obstacles to the collection of his debt. *National Tube Works Co.* v. *Ballou*, 146 U. S., 517.

In view of these long standing principles and of the Seventh Amendment to the Constitution of the United States and of Section 723 of the Revised Statutes, possibly it is not surprising that this court in considering the Mississippi statute involved in the two cases in question came to the conclusion that the statute simply operates to blend a proceeding at law with a proceeding in equity, which proceedings were entirely distinct one from the other.

In such a case the statute created no new right. Previous to its enactment the creditor had a full remedy at law and also after obtaining judgment had a full remedy in equity. The statute simply combined these remedies.

Even under these circumstances, in view of the fact that certain equitable rights or remedies were involved at some stage of the proceedings, the question was so doubtful even under such a statute that two able members of this Court, Mr. Justice Brown and Mr. Justice Jackson, felt obliged to dissent from the opinion of the Court in the *Cates* case, feeling that that statute should be held to be one that properly enlarged the jurisdiction of the Court. In that opinion it is stated:

> "I had always supposed it to be a cardinal rule of federal jurisprudence that the federal courts are competent to administer any state statute investing parties with a substantial right."

However this may be, the Mississippi statute there involved, and the Delaware statute involved in this proceeding are principally remarkable for their dissimilarity. There the provision was for the collection of a debt, here the provision is for the administration of the property of an insolvent corporation; there a judgment for the amount of the debt was to ensue, here no ascertainment of the debt may ever take place; there the debt was to be satisfied out of specific property, here the debt

may never be satisfied; there the procedure was from time immemorial fixed, here no such procedure existed previously.

We confidently submit that whatever decision the Court may come to upon the question here involved, it cannot consider that the case is governed by either *Scott* v. *Neely* or *Cates* v. *Allen*.

It is further worthy of remark that in the subsequent case of *Cowley* v. *Northern Pacific Railroad Co.* (159 U. S., 569), this Court upheld a proceeding in equity in the federal court based upon a state statute, in which case the opinion was written by Mr. Justice Brown, who dissented in the *Cates* case and in whose opinion the same cases cited in his previous dissenting opinion were relied upon, a fact which seemed to convince Judge Sanborn in the case of *Darragh* v. *H. Wetter Co., supra*, that this Court at least in a measure had modified its previous holding in the *Cates* case.

This question, therefore, not having been passed upon by this Court, we again point out the importance of the issues involved, the value of the remedies provided by statutes similar to the one in question and the practical necessities of an orderly and equitable administration of the properties of insolvent corporations.

POINT V.

Hanssen is a creditor of the petitioner corporation.

Some claim was made in the courts below and is more or less urged here that Hanssen is not a creditor of the petitioner. It seems to be claimed in the first instance that Hanssen is not a pledgee, but a mere custodian of the notes and, therefore, not entitled to sue. The question of whether he was a pledgee or otherwise of the

notes seems to be a question between Hanssen and Hannevig. The only reason alleged as to why he is not a pledgee, but is a mere custodian, is the fact that the instrument under which the notes were transferred to him states that they must be returned to Hannevig in case Hannevig pays his debt. As this is an incident of every pledge that ever existed so far as we know we will not pursue the question further, except to call the Court's attention to the fact that after these notes were pledged to Hanssen, Hannevig had occasion to pledge such equities as he retained in them to certain insurance companies, the contract in regard to which affair is in the record (p. 349). This contract is signed by Hannevig and there is attached to it a description of the securities in question, wherein Hannevig himself states that these securities

> "Are pledged to one Karluf Hanssen, of Haugesund, Norway, along with other collateral, all of which collateral is held by him to a debt of Christoffer Hannevig of approximately Seven Hundred Thousand Dollars"

(record, p. 354). There seems to be no misapprehension between Hanssen and Hannevig as to the nature of this transaction.

In the same connection it seems to be argued that Hanssen had no authority to bring the proceeding because such authority is not mentioned in the power of attorney with which he first came to America. We do not believe that such is the construction of that power of attorney, but whether it is or not is immaterial because before bringing the suit Hanssen returned to Norway and came back armed with further authority to institute the proceeding, all of which appears without contradiction in this record (p. 506).

The result of these transactions was to constitute

Hanssen a holder of these securities as collateral security as between himself and Hannevig, and further to constitute Hanssen a trustee under an express trust, so far as the nine Norwegian concerns go, for whose ultimate benefit the security was held.

As such a trustee under an express trust Hanssen could properly bring any proceeding that the holder of collateral could bring in the federal court. This is made apparent by the 37th rule in equity which, with the force of law, provides that a trustee of an express trust or a party with whom or in whose name a contract has been made for the benefit of another may sue in his own name without joining the ultimate beneficiaries. The contract between Hanssen and Hannevig appears in the record (p. 489). It furthermore appears that these nine Norwegian individuals and corporations have intervened in this proceeding and are now parties complainant, such intervention being under order of July 6, 1921 (record, p. 509) prior to the entry of the order on August 1, 1921, from which the appeal was taken (record, p. 603). It, therefore, appears not only that Hanssen was entitled to bring this bill, being expressly authorized to do so by the rules of this court, but that all the parties interested in said securities are now before the court.

It is further contended that the notes were not due and payable at the time Hanssen began this proceeding, and that the company had a valid defense to them. Neither of these contentions is sound.

Eight of the promissory notes were payable to Christoffer Hannevig, Inc., a New York corporation, by it were endorsed to Hannevig and by him were pledged to Hanssen. In reference to these notes Hannevig is an intermediate holder. The ninth note was payable to Hannevig and by him was endorsed in blank.

First: A pledgee of a note is a creditor of the maker.

Whether or not these notes were overdue when they were delivered to Hanssen, they nevertheless were transferrable by delivery.

> *National Bank of Washington* v. *Texas*, 20 Wallace, 72;
> *James* v. *Chalmers*, 6 N. Y., 209;
> *McSherry* v. *Brooks*, 46 Md., 118.

It is a well known rule of law that the pledgee of a promissory note is under obligation to collect the note and protect it in every way and to apply the proceeds on the debt for which the note is security. If he is negligent in this matter he may be held for his negligence. It, therefore, is not only his right but his duty to do everything he can to protect his status. If, therefore, he could sue the maker of the note to enforce it, it would seem to follow that he must be a creditor of that maker; otherwise, we would have a situation in which a person must and could procure a judgment on a note against the maker and yet not be a creditor of the maker.

Second: The notes are not subject to counterclaim.

The appellant, however, further contends that these notes, having been transferred after maturity, are subject to all equities between the original parties and, inasmuch as Hannevig had misappropriated seven hundred and fifty thousand dollars ($750,000) belonging to the maker of the notes, no action could be maintained on the notes, the argument seeming to be that such misapplication of moneys by Hannevig *ipso facto* extinguished the notes.

The status of these notes is important and we submit that the objections that have been raised to them are without merit.

No action was ever taken by The Pusey and Jones Company to offset this claim against the notes while Hannevig had them and, in fact, no such effort has ever been made, and it is also true that The Pusey and Jones Company never took any action waiving the tort on Hannevig's part. Whatever equities these notes may be subject to they are not subject to such a set-off or counterclaim in the hands of Hanssen.

(a) *A counterclaim or offset relates to the remedy and is governed by the law of the forum.*

The petitioner claims in its brief, pages 48 and 53, that this matter of counterclaim is governed by the laws of New York because the transfer took place in that State. This is not sound. It is universally held that a counterclaim is a matter of remedy and whether or not it can be successfully urged must be determined by the law of the forum.

> *Charnley* v. *Sibley*, 73 Fed., 980.
> Cyc. Vol. 34, page 648.

It, therefore, appears that this question must be determined by the law of Delaware and not by that of New York.

The cases cited in the opposing brief on pages 49 to 51, on the question of what law governs the propriety of this alleged counterclaim, are so far from the point that they do not require discussion.

(b) *A counterclaim is not an equity or defense to which a note transferred after maturity is subject.*

The demand which the petitioner claims extinguished these notes is one which manifestly had no relation whatever to the notes themselves. It grew out of an entirely independent transaction.

That such a counterclaim cannot be allowed has been the law in England for nearly a hundred years and has been applied under most extreme circumstances. This doctrine has been followed in most of the States, although a different doctrine prevails in a few, notably in New York. In that State, although there was considerable conflict in the early cases, the question was finally settled by statute.

This principle is referred to in the petitioner's brief as a "technical rule of common law" (p. 51). On the contrary, the doctrine is the fundamental one and the contrary doctrine is and always has been the exception.

This Court early announced its adherence to this proposition.

In *National Bank of Washington* v. *Texas* (20 Wallace 72), Mr. Justice Swayne makes the following statement (p. 88):

> "The transferee of overdue negotiable paper takes it liable to all the equities to which it was subject in the hands of the payee, but those equities must attach to the paper itself and not arise from any collateral transaction. A debt due to the maker from the payee at the time of the transfer cannot be set off in a suit by the endorsee of the payee although it might have been enforced if the suit had been brought by the latter."

The above is important not only because it is a pronouncement of this Court, but for the reason that the federal courts do not consider themselves bound by the decisions of the state courts on questions of general commercial law.

Railroad Co. v. *National Bank*, 102 U. S., 14.

The principal doctrine above discussed was also laid down in *Drexler* v. *Smith* (30 Fed., 754).

We have found no better discussion of the proposition than in the case of *Cumberland Bank* v. *Hann* (18 New Jersey Law, 222). The Court states (p. 225):

> "That the indorsee of a bill or note, after dishonor, takes it subject to all *equities* existing between the maker and any of the prior parties; that, as against such indorsee, the drawer, acceptor or maker, of any bill or note, may set up any *defence*, which he might have done against the indorser, is language familiar to every *lawyer*, and often repeated in our books; but still the question arises: what constitutes such *equities* or matters of *defence*, as may be set up by the maker of a note, against the payee, or the holder of the note, at maturity?"

and in answer to this question the Court further states (p. 227):

> "But a mere *right*, under the statute, to set-off distinct and independent claims, if the payee had thought proper to sue the defendant, was not *an equity* affecting the validity of the note, and following it into the hands of the plaintiffs. Nor, is the right of *set-off*, under the statute, either technically, or in any just and legal sense of the term, a *defence* or *bar* to an action. A matter which may be *set-off*, under the statute, is itself a *cause of action;* and when used by a defendant, as a set-off, it is not, as a *defence* or *bar* to the plaintiff's action. On the contrary it is an admission and in affirmance of, the plaintiff's right of action, and of his title to the money he seeks to recover; and it proposes to liquidate and satisfy the claim, by applying to that end, so much of the defendant's *own money*, then in the hands of the plaintiff, as will be sufficient for the purpose."

There are a multitude of authorities on the subject and a large number of them are cited at Section 725 of Daniels on Negotiable Instruments, to which reference is made in the opinion of the District Court below.

(c) *A promissory note transferred after maturity is not subject to equities between the maker and an intermediate endorser.*

It has been pointed out that many of the notes in question were not made originally payable to Hannevig but to a New York corporation, and that in reference to these notes Hannevig stands in the position of an intermediate holder. Again there is a great weight of authority to the effect that the equities to which an overdue note is subject in the hands of a transferee are only those that existed between the original parties to the note.

Cyc. of Law (vol. 34, p. 748).

Such is the law as laid down by this Court.

In *National Bank of Washington* v. *Texas* (20 Wallace, 72, *supra*), Judge Swayne said in reference to the equities to which a note transferred after its maturity was subject:

> "But the protection of this principle is confined to the maker or obligor. It does not apply as between successive takers. Actual notice is necessary to affect them. There is no adverse presumption. Each one takes the legal title, and his equity is equal to that of his predecessors. 'The equities being equal, the law must prevail.' The position of the transferee must be at least as favorable as that of the assignee of a chose in action. There the assignee takes subject to the equity residing in the debtor, but not to an equity residing in a third person against the assignor."

The Supreme Court of California has consistently held to this proposition beginning with tho case of *Vinton* v. *Crowe* (4 Calif., 309). We commend to the Court the opinion in this case as in every respect a model and quote it in full. It is as follows:

> "The defense relied on will not avail.
>
> If the plaintiff obtained the note after its maturity, he took it subject to all subsisting equities between the maker and the payee, but not subject to such as subsisted between the maker and any intermediate holder. Such a doctrine has never been countenanced by any authority whatever and would make a rule both dangerous and absurd.
>
> Judgment affirmed, with fifteen per cent. damages."

The same principle is laid down by the Court of Washington. *Reardon* v. *Cockrell*, (54 Washington, 400). The Court states:

> "It is stoutly maintained by the appellants that the rule of law is well established that one purchasing a chose in action after maturity takes subject to the equities in the case, or to equitable defenses which may be interposed to the claim. This rule is undoubtedly true as applied to equities which existed between the maker and the payee of the note, or as to any inherent disqualifications in the note. But we do not think it applies to cases of innocent purchasers of notes, where there would have been no defense to the action as against the original payee."

The same principle is approved in North Carolina and Illinois.

> *Hill* v. *Shields* (81 North Carolina, 250);
> *Woolford* v. *Rusk* (145 Ill. Ap., 405).

Many other cases might be cited in support of this proposition and it is submitted that it is a complete answer to the position of the appellant so far as the first eight notes are concerned.

It is further claimed (petitioner's brief, p. 51) that these rules do not apply as the notes were transferred as collateral security.

It is claimed that in the case of *Jenness* v. *Bean* (10 N. H., 266), decided some eighty years ago, the Court held the doctrine did not apply where the transfer of the notes was as collateral security. This case, which is the only one of the kind that has been discovered, seems to support that contention, but it is undoubtedly founded on the old idea that a pre-existing indebtedness is not a valid consideration for the transfer of collateral security. This proposition has been discarded by numerous decisions in most of the states and particularly by the decisions of this Court which has consistently held from the beginning that a pre-existing indebtedness is a valid consideration for the transfer of collateral security.

In *Swift* v. *Tyson* (16 Peters, 1), a case which has been followed by many subsequent decisions, Mr. Justice Story stated:

> "We have no hesitation in saying that a pre-existing debt does constitute a valuable consideration in the sense of the general rule already stated as applicable to negotiable instruments."

It is also alleged (p. 52) that a different doctrine prevails in equity with reference to offsets than that which prevails at law. This is true to a very limited extent.

The brief cites the case of *Rolling Mill* v. *Ore Steel Company* (152 U. S., 596). The case simply involved the question of whether a garnishee could offset a debt which the principal debtor owed him, or whether he would have to pay the garnishor and lose his claims against the principal debtor, who was insolvent. It would seem to us that such a situation presented a question that could not well have been decided otherwise and one entirely without difficulty. What it has to do with the present case is not apparent.

On page 53 of the brief there is a list of seven more cases alleged to support the petitioner's proposition. The

two New York cases can be discarded because New York is the State which has always held that such an offset is proper at law. The Vermont case was one in which a statute was involved and also the plaintiff was a nominal party only. The Maine citation is erroneous. There is no such case.

The California case simply involved the question of whether judgments could be set-off, where one was in the name of a trustee but the *cestui que* trust was the real party in interest. It was held that a judgment against the *cestui que* trust could be offset.

In the Pennsylvania case the Court held that judgments could be offset against each other as between the parties to the action, but the case is an authority for the respondent because an assignee of part of one of the judgments was protected.

It is submitted that without question the alleged counterclaim is not good as against Hanssen.

Third: The agreement whereby Hannevig undertook not to collect the notes until the Shipping Board mortgage was paid does not affect the situation.

In the first place, an agreement of this sort contained in a separate writing, as this was, and not endorsed on the notes, is not one of the equities to which a note transferred after maturity is subject, for the reason that it is an agreement contradicting the terms of the note itself.

In Daniels on Negotiable Instruments, Section 724, appears the following:

> "It is competent against the transferee after maturity to show any equities attaching to the paper itself, but not to show by parole evidence that it was not to be negotiated or not sued on until a certain event, for this would be to contradict the written contract by mere parole."

See also:

Lively v. *Picton,* 218 Fed., 401.

It must follow that Hanssen was a creditor of The Pusey and Jones Company within any reasonable definition of the term and regardless of the alleged contract by which the notes could not be collected until the Shipping Board mortgage was paid.

POINT VI.

The decree of the Circuit Court of Appeals should be affirmed.

Respectfully submitted,

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